United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL

75-7069

United States Court of Appeals
FOR THE SECOND CIRCUIT

B

P/S

Docket Nos. 75-7069, 75-7208

COMPANIA ESPANOLA DE PETROLEOS, S.A.,
Plaintiff-Appellant-Cross-Appellee,

against

NEREUS SHIPPING, S.A.,
Defendant-Appellee-Cross-Appellant.

Docket No. 75-7206

HIDROCARBUROS y DERIVADOS, C.A.,
Plaintiff-Appellee,

against

NEREUS SHIPPING, S.A.,
Defendant-Appellant,

and

COMPANIA ESPANOLA DE PETROLEOS, S.A.,
Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT,
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF NEREUS SHIPPING, S.A.

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REPLY BRIEF OF NEREUS SHIPPING, S.A.

This brief is submitted by Nereus Shipping, S.A. (hereinafter referred to as "Nereus"), as its answering appellee's brief in Docket No. 75-7069, and as its appellant's reply brief in Docket Nos. 75-7206, 75-7207 and 75-7208.

This matter involves four appeals, from two actions for injunctive relief, and one petition under the Federal Arbitration Act, 9 USC § 5, for the appointment of a third arbitrator in the arbitration between Nereus and Hidrocarburos y Derivados, C.A. (hereinafter referred to as "Hideca").

The three appeals in which Nereus is appellant are from the order of the United States District Court for the Southern District of New York dated March 21, 1975 upon the decision of the Honorable Charles E. Stewart (A-218 to A-222).* Judge Stewart's decision was entered in an action by Hideca for an injunction, 75 Civil 463, and in a proceeding by Hideca for the appointment of a third arbitrator in the Nereus-Hideca Arbitration, 75 Civil 464. By order of the Court, the same decision was filed in the prior action by Compania Espanola De Petroleos, S.A. (hereafter referred to as "Cepsa") against Nereus, 74 Civil 5102, with the result that it erroneously modified the prior decision of the Court dated December 18, 1974 while there was an appeal to this Court pending in that action (A-99-A-107).

Statement

Both Hideca and Cepsa in their brief wrongly assert that Addendum No. 2 to the Contract (A-49) was simply a guaranty by Cepsa of the obligations of Hideca under the Contract. At page 1 of its brief, Hideca describes

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* References to page numbers with the prefix "A" are to pages of the Joint Appendix.

Cepsa as "the guarantor of the Charterer (i.e. Hideca)." At page 3 Hideca states that "Addendum No. 2 to the Contract dated June 24, 1971 (See A-16e: hereinafter referred to as the "Guaranty") provided a guaranty of Hideca's performance under that Contract by Cepsa." Cepsa states at page 16 of its brief "Its (i.e. Addendum No. 2) only purpose was to secure the performance of Hideca under certain named conditions and had nothing to do with the transportation of the cargoes."

These statements by Hideca and Cepsa are erroneous and are contradicted by the express language of Addendum No. 2. They are intended to suggest to this Court that what is involved is a charterparty and a separate letter of guaranty of payment of sums found to be owing by the charterer to the owner.

In fact Addendum No. 2 was made and marked as an addendum to the Contract. It specifically provided that Cepsa was not liable for and did not guaranty payment of the obligations of Hideca as charterer under the Contract. The final sentence of Addendum No. 2 (A-49) stated in clear and unambiguous language as follows:

> "Provided, however, that Compania Espanola de Petroleos, S.A., shall not be responsible for any payments or damages as a result of HIDECA's default, prior to receiving written notice from the Owner advising us that HIDECA is in default, and calling upon us to assume performance of the Charter Party."

In the face of the language of Addendum No. 2, it is both incorrect and misleading for Cepsa to state at page 24 of its brief that "Cepsa's obligations under the Guaranty have been reduced to pay damages in the event Hideca cannot."

It is equally incorrect and misleading for Cepsa to state at page 16 that Addendum No. 2 "had nothing to do with

the transportation of cargoes," since Addendum No. 2 provided as follows:

> "* * * we, Compania Espanola de Petroleos, S.A., hereby agree that, should HIDECA default in payment or performance of its obligations under the Charter Party, we will perform the balance of the contract and assume the rights and obligations of HIDECA on the same terms and conditions as contained in the Charter Party."

Only by attempting to distort the clear language of Addendum No. 2 can Hideca and Cepsa seek to treat this matter as though Hideca were the principal and Cepsa simply the guarantor of payment so as to rely on many of the cases cited in their briefs. Cepsa has no liability for monies owed by Hideca under the Contract and has not guaranteed payment of any arbitration award against Hideca. By its terms, Cepsa was required by Addendum No. 2 only to perform the balance of the Contract upon the failure of Hideca to make a payment or perform an obligation under the Contract. Such performance by the shipment of approximately 450,249 tons of cargo was never carried out by Cepsa.

POINT I

Addendum No. 2 of the Contract incorporated the arbitration clause and requires Cepsa to arbitrate with Nereus the question of Cepsa's refusal to ship the balance of the cargo.

As indicated above, Cepsa has referred to cases involving a separate guaranty of payment to argue that it was not bound by the arbitration clause of the Contract. In this regard it has quoted from this Court's unreported decision in *Interocean Shipping Co.* v. *National Shipping and Trading Corp.* (June 24, 1975), where neither the charterparty nor the guaranty were ever executed. The only ref-

erence to a guaranty was in the fixture telex which stated as follows:

> "Charterer: Hellenic International Shipping S.A. of Panama Subsidiary of National Shipping and Trading with appropriate Letter of Guarantee."

In contrast, Cepsa did not guaranty payment of the obligations of Hideca. Instead by Addendum No. 2, which was not a separate instrument but a part of the Contract, Cepsa agreed to "perform the balance of the contract and assume the rights and obligations of Hideca on the same terms and conditions as contained in the Charter Party (i.e. Contract)." Such language is the language of novation and the terms of the Contract included the arbitration clause. Addendum No. 2 did not contain any language excluding arbitration from the rights and obligations which Cepsa agreed to assume.

In the *Interocean* case, this Court held, in part, as follows:

> "True, the mere fact that a party did not sign an arbitration agreement does not mean it cannot be held bound by it. Ordinary contract principles determine who is bound."

Cepsa signed Addendum No. 2 to the Contract and agreed that upon notification of Hideca's failure to pay or perform its obligations under the Contract, Cepsa would perform the balance of the Contract. Under such circumstances Cepsa was bound by the arbitration clause based on ordinary contract principles.

Judge Stewart in his decision dated December 18, 1974 correctly rejected Cepsa's interpretation of Addendum No. 2 as follows (A-106):

> "In so holding, we do not find Cepsa's interpretation commercially reasonable. If plaintiff's interpretation

were correct, Cepsa would never be bound to perform any of the obligations of Hideca until it were first conclusively determined, presumably by arbitration, that Hideca was in default, and until judicial appeals were exhausted. If this procedure were followed, plaintiff's guaranty would be limited effectively to paying damages at some point in the future to the defendant, unless Cepsa were willing to concede that Hideca was in fact in default. We thus conclude that Cepsa's obligations under the Letter of Guaranty came into play as soon as it received the notification from Nereus that Hideca was in default."

In *Taiwan Navigation Co.* v. *Seven Seas Merchant Corp.*, 172 F. Supp. 721 (SDNY 1959) referred to by Cepsa at page 14 of its brief, the guarantee only stated: "It is understood that Kervin Shipping Corporation will guarantee performance of Seven Seas Merchant Corporation under the Charterparty." There was no undertaking by the guarantor to perform the balance of the charterparty and no agreement to assume the rights and obligations of the Charterer on the same terms and conditions as contained in the Charterparty. The same is true of the other cases involving ordinary guarantors of the obligations of a charterer cited in Cepsa's brief.

POINT II

No Court decision has held that the Federal Arbitration Act authorizes an order directing consolidation of separate arbitrations before a single arbitration panel.

In *Robinson* v. *Warner,* 370 F. Supp. 828 (D.C. R.I. 1974), cited by Judge Stewart and relied upon in both the Hideca and Cepsa briefs, the Court held, in part, as follows:

"Defendant Warner is correct that 9 U.S.C. § 4 provides only that the Court may issue an order 'directing

> the parties to proceed to arbitration in accordance with the terms of the agreement,' and in no way specifically authorizes the Court to order a consolidated arbitration with a dispute arising out of a separate and distinct contract, when neither contract explicitly provides for such joint arbitration."

The Court also stated that "no Federal Court appears to have addressed this issue directly." That state of affairs has continued to the present with the exception of the decision in *Gavik Construction Co.* v. *The Wicker Corp.*, 389 F. Supp. 551, 555, 556 (W.D. Penn. 1975) when the Court did not follow the *Robinson* case and held, in part, as follows:

> "Having determined that both Gavlik and Wickes are obliged to arbitrate their disputes with Campbell, the next question is whether consolidated arbitration is properly ordered. We hold that it is not.
>
> The court notes once against that arbitration is a matter of contract, and parties cannot be forced to arbitrate matters they have not agreed to arbitrate. John Wiley & Sons v. Livingston, 376 U.S. 543 (1964).
>
> * * *
>
> Campbell cites Uniroyal, Inc. v. A. Epstein and Sons, Inc., 428 F. 2d 523 (7th Cir. 1970), holding that the subcontractor is bound to participate in a consolidated arbitration. Campbell also cites Robinson v. Warner, 370 F. Supp. 828 (D.R.I. 1974), in which the court construed Rules 81(a)(3) and 42(a) of the Federal Rules of Civil Procedure to require consolidated arbitration among the contractor, the architect, and the owner. The law on this question, is not settled, however, as the Robinson court, particularly notes.
>
> We cannot accept defendant's broad reading of the arbitration provision. The agreement itself fails to specify consolidated arbitration and the provision in

> Article 22 that the arbitrators be chosen 'one by the contractor' and 'one by the subcontractor' (and the third by the first two), clearly implies that only those two parties were expected to participate in any arbitration. No mention is made of how an arbitration would occur involving a three-party dispute. This alone distinguishes Uniroyal, Inc., supra."

The Court in the *Robinson* case, while conceding that the Federal Arbitration Act "in no way specifically authorizes the Court to order a consolidated arbitration" of separate disputes, based its decision ordering consolidation on Rules 81(a)(3) and 42(a) of the Federal Rules of Civil Procedure. The Court in the *Gavlik* case in a similar situation agreed that the Federal Arbitration Act did not authorize consolidation and stressed that arbitration is a matter of contract. It did not consider that Federal Rules of Civil Procedure permitted the Court to change the contracts made by the parties with respect to arbitration of disputes.

The Federal Arbitration Act is the basis of the jurisdiction of the District Court with respect to arbitration under the Contract, which was a maritime contract within the meaning of 9 USC § 1. In this regard, in *Orion Shipping & Trading Co., Inc.* v. *Eastern States Petroleum Corp. of Panama, S.A.*, 284 F. 2d 419 (2d Cir. 1960), this Court held in part, as follows:

> "As Judge McGohey well said: 'No issue of fact requiring summary trial is raised whether Orion be considered the principal or the agent for an undisclosed principal.' The additional argument that the libelant's claim was not cognizable in admiralty is equally devoid of merit. The contract of affreightment was a maritime transaction as defined in § 1 of the Arbitration Act, 9 U.S.C.A. § 1. Panama repudiated its obligation; hence the court had jurisdiction of the subject matter of the controversy."

Since the jurisdiction of the District Court was based upon the Federal Arbitration Act (which in Section 4, 9 USC § 4 authorized the Court to enter "an order directing that such arbitration proceed in the manner provided for in such agreement" and further provided that such order should be one "directing the parties to proceed to arbitration in accordance with the terms of the agreement)," the District Court under its procedural rules could not disregard the statutory mandate.

The holding of Judge Stewart indicates that he erroneously considered that Section 4 of the Federal Arbitration Act, 9 USC § 4, authorized an order directing consolidation of two separate arbitrations before a single panel of five (5) arbitrators.[1]

Rule 81(a)(3) of the Federal Rules of Civil Procedure provides that the Civil Rules apply to proceedings under the Federal Arbitration Act "only to the extent that matters of procedure are not provided for in those statutes." However, the decision of Judge Stewart dated March 21, 1975, which he based in part on Rules 81(a)(3) and 42(a), was not procedural with respect to the Nereus-Cepsa and Nereus-Hideca arbitrations but on the contrary was substantive and violated the arbitration agreements of the respective parties.

In *Foremost Yarn Mills, Inc.* v. *Rose Mills, Inc.*, 25 F.R.D. 9, 11 (E.D. Penn. 1960) the Court held, in part, as

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[1] Judge Stewart held, in part, as follows (A-219):

> "There is sufficient power in a federal district court to compel consolidation of two related arbitration proceedings, under Rules 81(a)(3) and 42(a) of the Federal Rules of Civil Procedure, and under 9 U.S.C. § 4, even where the agreements to arbitrate are embodied in separate contracts (although there is one common party to both agreements), and neither of the separate contracts provide for consolidated arbitration."

follows:

> "It would appear that plaintiff misapprehends the effect of Rule 81(a) (3). The Rule relates solely to proceedings under Title 9 U.S.C.A. §§ 1 to 14 inclusive. The present action is not such a proceeding. It is an ordinary action for a preliminary injunction based upon a claim of irreparable harm. What plaintiff here attempts to do is to relate the arbitration proceeding proper (i.e., the process whereby the arbitrators are made aware of the operative facts surrounding the contract, weigh these facts, and reach a decision) to a proceeding under the Arbitration Act itself, 9 U.S. C.A., Section 1 et seq. The latter proceedings are limited in scope and have nothing to do with the merits of the real controversy.
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> * * *

In *Penn Tanker Co. of Delaware* v. *C.H.Z. Rolimpez, Warszawa,* 199 F. Supp. 716 (S.D.N.Y. 1961), the Court held, in part, as follows:

> "Respondent has not argued that Rule 81(a)(3), Fed. Rules Civ. Proc., 28 U.S.C., compels a different result.
>
> * * *
>
> Title 9 does not deal in terms with discovery although sections thereof do deal with 'matters of procedure'; e.g., §§ 4 and 7. An argument could be made that the Federal Rules should be applied to proceedings under Title 9 to the extent to which they are mutually consistent. It may be that there is a limited area for application of discovery procedures to proceedings under Title 9; e.g., on the issue of whether there was an agreement to arbitrate which the Court must decide under § 4 before directing the parties to proceed to arbitration. (Citing cases) But I do not think that Rule 81(a) (3) is designed to allow judicially imposed

> and controlled discovery as to the merits of a controversy which will be referred to arbitration under 9 U.S.C. § 4."

Rule 42(a) entitled "Consolidation; Separate Trials" concerns trials before the District Court of "actions" pending therein. However, the only issue with which the District Court could be concerned was the existence of an agreement to arbitrate and Rule 42(a) would apply to hearings or a trial on that issue. The order of the District Court i) removing the entire arbitration panel of the Nereus-Cepsa Arbitration, which it had previously held to have been properly appointed and ii) directing a consolidated arbitration before a panel of five (5) arbitrators selected in a manner contrary to the arbitration agreements of the parties, is contrary to Rule 42(a) and the substantive provisions of the Federal Arbitration Act and the terms of the Contract and Addendum No. 2.

The Federal Rules of Civil Procedure do not empower the District Court to violate the terms of the arbitration agreement between the respective parties. In *Strauss* v. *Silvercup Bakers, Inc.*, 353 F 2d 555, 558 (2d Cir. 1965), this Court stated the underlying principle concerning enforcement of arbitration agreements as follows:

> "The duty to arbitrate being contractual in origin, the court must make an effort to construe the extent of that contractual duty, rather than force arbitration even of arbitrability upon parties who did not bind themselves to such submission."

Rules 81(a)(3) and 42(a) do not authorize the order of the District Court dated March 21, 1975.

POINT III

Consolidation of the separate arbitrations before five arbitrators selected in the manner directed by the District Court is prejudicial to Nereus.

Since Cepsa did not guaranty the obligations of Hideca to Nereus under the terms of Addendum No. 2, any disputes between Nereus and Hideca during the period of voyages Nos. 1 to 17 from December 24, 1971 to July 24, 1974, when Nereus notified Cepsa to perform the balance of the Contract, will not involve Cepsa. To have such disputes arbitrated in a consolidated arbitration is prejudicial to Nereus.

Furthermore, the District Court by its decision dated March 21, 1975 has removed the entire panel in the Nereus-Cepsa Arbitration without cause and contrary to settled law in this respect. (See Point V of Nereus' Brief and cases cited therein, to which neither Hideca nor Cepsa have replied.)

However, the most obvious prejudice to Nereus results from the manner in which the District Court has directed the arbitration panel for the consolidated arbitration to be selected. This is not a case where the party in the middle has a claim over against either one or the other of the remaining two parties. Instead, Hideca and Cepsa have a common interest as adversaries of Nereus.

Despite this fact, the District Court has ordered that in effect Nereus' adversaries should appoint four (4) of the five (5) members of the arbitration panel. Nereus will appoint one (1) arbitrator while its adversaries will appoint two (2) arbitrators. Those three (3) arbitrators may then select two (2) more arbitrators (by a 2 to 1 vote in each case) to complete a five (5) member panel, which will be different in number and manner of selection from that specified in the arbitration agreements. Such a result is

clearly prejudicial to Nereus and not supported by any judicial authorities.

There has been no reported case involving the Federal Arbitration Act where a court has removed a properly appointed arbitration panel and, over the opposition of the party common to two separate arbitration agreements,[2] directed a consolidated arbitration before a new and larger panel selected predominantly by its opponents.

POINT IV

Nereus' appeal from the order dated March 21, 1975 is proper.

There is no disagreement that the arbitrations involved herein are subject to the Federal Arbitration Act. Section 4 of that Act, 9 USC § 4, is the only provision authorizing the District Court to issue an order directing or compelling arbitration and Judge Stewart specifically referred to Section 4, 9 USC § 4 (A-219 quoted at page 8 herein).

The law is clear that an order directing parties to proceed to arbitration under 9 USC § 4 is appealable. See *Farr & Co.* v. *Cia. Intercontinental De Navigacion,* 243 F. 2d 342 (2d Cir. 1957). The order appealed from not only directed that Nereus proceed to arbitration jointly with Hideca and Cepsa in a consolidated arbitration, but also

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[2] In this regard Judge Stewart stated as follows (A-221):

> "Nereus contends that there is no precedent for consolidating two arbitration proceedings where the party common to both proceedings opposes consolidation. Although we have found no case ordering consolidation in such circumstances, we do not believe that this court is without power, in its discretion, to order consolidation where common questions of law or fact are present. It is also within our discretion, we believe, to order consolidation before a panel of five arbitrators, even though the parties originally agreed to arbitrate their disputes before a panel of three."

removed the Nereus-Cepsa Arbitration panel, modified the arbitration agreements between the parties and was the final order in the proceedings. As such it was not an interlocutory order in a pending proceeding but a final order directing arbitration in a manner contrary to the Federal Arbitration Act and the terms of the Contract and Addendum No. 2.

POINT V

The order of the District Court dated December 18, 1974 denying Cepsa's motion for declaratory and injunctive relief is not appealable.

Insofar as the decision of Judge Stewart dated December 18, 1974 (A-99 to A-107) denied Cepsa's motion for an injunction, it was clearly not appealable.[3] As indicated in the *Orion* case, *supra,* the matter was within the admiralty jurisdiction of the Court.

In the case of *Schoenamsgruber* v. *Hamburg American Line,* 294 U.S. 454, 79 L. Ed. 989 (1935), the Supreme Court held that an order staying an admiralty action pending arbitration is not appealable and stated, in part, as follows:

> "The cases now before us are in admiralty. The orders appealed from merely stay action in the court pending arbitration and filing of the award. As shown by the *Enelow* Case, they are not interlocutory injunctions within the meaning of § 129. And plainly, so far as concerns appealability, they are not to be distinguished from an order postponing trial of an action at law to await the report of an auditor."

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[3] Judge Stewart's decision and order (A-107) stated: "For the reasons indicated, plaintiffs' motions for declaratory and injunctive relief are denied."

The Supreme Court also held, in part, as follows:

> "While courts of admiralty have capacity to apply equitable principles in order the better to attain justice, they do not have general equitable jurisdiction and, except in limitation of liability proceedings, they do not issue injunctions."

In *Moran Towing & Transportation Co.* v. *United States,* 290 F. 2d 660 (2d Cir. 1961), this Court held, in part, as follows:

> "While this is not a situation covered by the Federal Arbitration Act, 9 U.S.C. § 1 et seq., as the Disputes Clause here does not provide for arbitration, or for the appointment of arbitrators, it is closely analogous to arbitration and we think the reasoning of the cases holding stays in pending actions to await the decision of arbitrators to be interlocutory and not appealable [citing cases]
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> * * *
>
> "The power of admiralty to issue injunctions appears to be circumscribed; some authorities deny any power except in limitation proceedings * * *."

In *Penoro* v. *Rederi A/V Disa,* 376 F. 2d 125 (2d Cir. 1967), this Court held, in part, as follows:

> * * *
>
> "Rederi now contends that *Schoenamsgruber* and our own decisions following it, are in some fashion undercut by the unification of civil and admiralty rules which became effective July 1, 1966."
>
> * * *
>
> "The new rules make clear that actions in admiralty are *not* to be treated like actions in law in every respect."
>
> * * *

> "Although none of the rules referred to in Rule 9(h) deal directly with interlocutory appeals under § 1292 (a) (1), the absence of such a reference does not mean the draftsmen intended to change § 1292 (a) (1) in any way. The Ettelson case teaches that the separate 'sides' of the district court may survive unification for purposes of § 1292 (a) (1). Since a court in admiralty had the power to stay its own proceedings without the aid of equity prior to unification, there is no reason to believe that it somehow lost that power as a result of unification."

At the time Cepsa moved for injunctive relief, the Nereus-Cepsa Arbitration Panel had been appointed "in accordance with the arbitration clause of the contract" as found by Judge Stewart (A-101). Under the cases referred to in pages 28 to 30 of Nereus' Brief the parties had designed their own remedy for recalcitrance and the arbitration agreement was self-executing. Accordingly no order under 9 U.S.C. § 4 compelling arbitration was required and the District Court correctly denied Cepsa's motions and did not enter an order directing arbitration.

In *Aeronaves de Mexico S.A.* v. *Triangle Aviation Services, Inc.*, 389 F. Supp. 1388, 1391 (SDNY 1974), where the Court denied plaintiff's motion for a stay of arbitration and dismissed its action for declaratory relief, the Court held; in part, as follows:

> "Where the issues in an action for a declaratory judgment parallel and duplicate the issues appropriately before the arbitrators, the Court may dismiss the action or deny all relief, or declare and enforce defendant's rights to arbitrate. *Necchi S.p.A.* v. *Necchi Sewing Machine Sales Co.*, supra, 348 F. 2d at p. 696. An order compelling arbitration under § 4 of the Federal Arbitration Act is appropriate here."

Judge Stewart's decision dated December 18, 1974 was in accordance with the holding of this Court in *American Home Insurance Co.* v. *American Fidelity and Casualty Co.*, 356 F 2d 690, 693 (2d Cir. 1966) stating, in part, as follows:

> "Having chosen in advance such a tribunal, appellant may not enlist the aid of the courts to delay or defeat its proper functioning. (Citing cases)"

CONCLUSION

The order of the District Court dated March 21 should be reversed and the decision of the District Court dated December 18, 1974 should be affirmed.

Respectfully submitted,

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Due and timely service of Two copies
of the within BRIEF is hereby
admitted this 16TH day of SEPTEMBER 1975

.....
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